CONTROL OF LIFE INSURANCE COMPANIES

From the standpoint of control, there are three classes of life insurance companies: stock companies, mixed companies, and mutual companies. The stock companies were the first in the field, writing a small amount of purely non-participating business. About 1840, companies began to be organized on a mutual basis, and these soon drove the three old stock companies out of the life insurance field. In the twenty years following 1840, practically all the prominent mutual companies of to-day were organized. Following the organization of these successful mutual companies came the formation of a large number of stock and mixed companies, as a result partly of the desire on the part of capitalists to engage in an apparently profitable business, and partly of the enactment of state laws, which from that day to this have made the formation of a mutual company difficult.

Control of stock companies is, of course, lodged in the hands of stockholders, and problems connected with their management would be no more serious than those arising in the management of any joint stock company, if it were not for two conditions. In the first place, these companies are permitted to write participating as well as non-participating policies; that is, they are allowed to solicit business on promise of a division of profits among purchasers of their product. This differentiates a stock life insurance company from any other joint stock concern. Although some of the leading stock companies may have paid nearly as large dividends to their participating policy-holders as have been paid by mutual companies, it is still true that the privilege granted these companies is of doubtful advantage to the best interests of the business. If the dividends upon the capital stock are limited in amount, there is no added incentive to the officials through the existence of the capital stock to manage the company well, and the capital stock remains as a dangerous weapon by means of which men can obtain control of the company. If the dividends are not limited in amount, there is the possibility that the participating policy-holders will be mulcted to the advantage of the stock-holders. If, as in the

case of some companies, the dividends beyond a certain amount which the company can pay upon the capital stock are limited to the profits made from the non-participating policy-holders, the division of the fixed charges of the company can be so arranged as not to do substantial justice to the participating policy-holders. For these reasons the state is justified, if not in prohibiting stock life insurance companies from writing participating policies, at least in exercising much more control over their affairs than is exercised over other corporations.

The second peculiarity differentiating stock life insurance companies from other corporations is that the stockholders of the life company soon come into nearly absolute control of much larger assets than the capital originally invested. To be sure, this is true in a way also of banks and other fiduciary institutions, but the insurance company differs radically from a bank in that its reserves, unlike deposits, cannot be withdrawn at the will of those to whom they belong. No matter how inefficient the management of a stock company, there may be no weeding-out of incompetent men. The policy-holders, who are the most interested, have no redress. They cannot withdraw their savings, thus showing their disapproval of the management, without a considerable financial sacrifice. They cannot change the management. The men in control own the capital stock, and to displace them it is necessary that a controlling interest in the capital be purchased. Not always have owners of a majority interest been willing to sell; only an aroused public opinion has forced them to part with the control of a company.

Furthermore, stock life insurance companies are at the mercy of designing financiers who may seek to control them. All the stock companies are subject to this danger, and many have suffered already. The American Life of Philadelphia was wrecked in two years by men who surreptitiously purchased a controlling interest.[1] These men never had any intention in purchasing the stock other than to possess themselves as quickly as possible of the American's valuable assets. A similar disaster to the Phoenix Life of Hartford, which at one time had a guarantee capital, was averted only by a special session of the Connecticut Legislature, which passed an act changing it into a purely mutual company.[2] The Equitable

[1] *The Insurance Spectator,* 1890, p. 305, and the *Pennsylvania Life Insurance Report for 1889.*

[2] P. Henry Woodward, *History of Insurance in Connecticut,* p. 97.

and the Washington of New York are at the present time under the domination of one man. The Prudential of New Jersey is controlled absolutely by a small group of men, who, in 1902, tried to avoid the necessity of keeping even six million dollars invested as a controlling interest in Prudential stock. The scheme for effecting this release was as follows: The Prudential Insurance Company was to purchase a controlling interest in the Fidelity Trust Company, and a contract was entered into between the Fidelity and the majority interest of the Prudential stockholders, in which the latter contracted to sell their holdings of Prudential stock to the trust company.[3] In this way the directors of the Prudential could have perpetuated their control without any financial outlay whatever. The plan was defeated by an appeal to the Courts brought by the Massachusetts Insurance Commissioners,[4] but President Dryden has since announced that the "good" results of such a merger have been secured in an unobjectionable manner.[5] A New Jersey investment company controls the Bankers' Life of New York,[6] while a few years ago a coterie of New York financiers purchased a controlling interest in the United States Life of that city. It is not asserted that all the companies which have here been enumerated have suffered through the control exercised by the capital stock; on the contrary, some of them have been most excellently managed by stockholders. Some, however, have already suffered seriously, and it is believed that all in which the control is lodged exclusively in a few hands are in a precarious position. The assets which the stockholders control really belong to the policy-holders, and yet the policy-holders cannot withdraw that which belongs to them, since they have entered into long-time contracts.

Certainly the problems connected with management of stock life insurance companies are serious; so serious, indeed, that it is urged in many quarters that the state should not allow such companies to be organized. All insurance is essentially mutual in principle; the mutual system has demonstrated its fitness in dealing with life contingencies, and if the states would amend their laws, capital stock would be unnecessary in starting a life insurance com-

[3] *Massachusetts Life Insurance Report,* 1902, Preface.

[4] *The Insurance Spectator,* 1902, p. 223.

[5] *Massachusetts Insurance Report,* 1903, p. xxxix.

[6] *The Insurance Age,* 1904.

pany;[7] legislatures might not be entirely unjustified in prohibiting the formation of stock life companies.

As regards control, a company which is mixed—that is to say, a company which has capital stock but which allows policy-holders to vote—possesses no considerable advantages over a purely stock company. The restrictions placed upon the policy-holders' voting powers are such in most cases that the concession has little practical value. For instance, the Michigan Mutual is a mixed company with $500,000 of capital stock. Each share of stock has a vote. In addition, policy-holders insured for life for $5,000 may vote in person only.[8] The management can rest assured that 5,000 persons carrying $5,000 policies of a particular kind will never present themselves in Detroit to cast their ballots in person. In the Metropolitan of New York, there are 40,000 shares of stock. Policy-holders paying $100 premium per annum may vote, but two-thirds of the directors must be stockholders, so that the privilege granted to the policy-holders is worthless.[9] The Manhattan has a thousand shares of stock, each share entitling its owner to one vote. Policy-holders paying an annual premium of $75 on a life policy may vote, but half of the directors must be stockholders.[10] Half of the board with the president is all that is needed for control, even if the policy-holders should elect all the directors to which they are entitled. The Home is likewise a mixed company. Policy-holders paying $80 annual premium may vote.[11] The testimony before the Armstrong committee showed that the Home has never been troubled with policy-holders voting; in the forty-seven years of its existence, only one policy-holder has appeared to cast his ballot.[12] It does not appear that mismanagement has been so common in the history of mixed companies as in the case of stock companies, and this is due, perhaps, to the latent

[7] Nearly all states insist upon a system of net valuation of policies. Under such a system it is practically impossible to start a new life insurance company, unless capitalists stand ready to make up deficiencies during the early years. In other ways, state laws have been so framed as seriously to discourage the formation of any but stock companies.

[8] Article IV of constitution.

[9] *New York Laws of 1868*, chap. xlviii, §§ 6 and 11.

[10] Charter, §§ 5, 8, and 9.

[11] Charter, Art. V.

[12] Testimony of George E. Ide, *Armstrong Report*, p. 3587.

possibility that policy-holders will assert their rights; nevertheless a mixed company would seem to be, for all practical purposes, a stock company, and as regards control it presents most of the problems and dangers inherent in a stock company.

Nor is the question of management and control solved when companies are made mutual in their organization. The system of mutual life insurance contemplates a management elected by the policy-holders and responsible to them. This theory of government has, however, never been worked out in practice in the United States according to the spirit of its constitution. The long distances and the expenses of traveling have made it impossible from the beginning for policy-holders to cast their ballots in person. Resort has been made to proxy voting, and the result of proxy voting as allowed by most of the states has been to make the management of mutual companies as certain of tenure, and hence as careless of the rights of policy-holders, as have been the managements of stock companies. State laws have placed few restrictions on the collection and voting of proxies. In some instances policy-holders have even signed a proxy when making application for a policy; in many instances, they have given their rights to the officials for long periods. A part of the agents' work each year has been to gather proxy votes, and send them in to the home office, so that the management should have at all times a sufficient number of proxy votes to defeat any movement of opposition on the part of dissatisfied policy-holders. The companies have always gone about the gathering of proxies quietly, for they have not cared to remind members of their rights, yet they have succeeded in keeping a large number always on hand.

Whoever in the company controls the proxies, controls the company. In 1870, there was an internal conflict in the Mutual Life. On the day of the election, a considerable number of policy-holders appeared in person to vote. President Winston of the company controlled ten thousand proxies. In the afternoon, with the outcome of the election in doubt, Winston appeared with several thousand of the proxy votes, cast them in favor of himself, and the day was won.[13] The same thing has happened often enough to show the policy-holders the futility of opposition. Policy-holders have

[13] President Winston's circular letter of April 16, 1877, to the policy-holders of the Mutual Life. See also, Julius Wilcox, *Scribner's Magazine*, Vol. XIV, pp. 382, 383.

come to take no interest in the active management of companies, and certain officials have stayed in power so long that they have come to look upon their company as a personal asset, the sense of private property becoming so strong in some cases that they have felt that control of a company ought to be inherited.[14]

Officers of all the companies are practically unanimous in declaring that the present system of voting in mutual companies, or rather what was the system a year and a half ago, should not be changed. That section of the Armstrong law which changed the method of voting in mutual companies was vigorously opposed by the New York companies, and during the past winter similar legislation in other states has met the opposition of the mutual companies in those states. Many of the officials recognize that the old system is far from ideal, but they believe that the proposed reforms will lead to worse conditions in making an annual contest for the control of the companies a probable event. They hold that any changes in the laws calculated to make such yearly contests for control inevitable, will do more harm to the insurance business than the present system has done. They urge that it is not fair to subject a company, which has been brought to a successful stage of its existence through efforts of its officers, to annual contests for control. Such contests, it is believed, will surely follow the adoption of the proposed reform methods of voting. They point out that men are always willing to listen to evil reports regarding anybody in power; and that the greater the ease with which a change in administration can be secured, the greater the chance of success for selfish and unjust methods which will be used for securing a change. As a final objection, they maintain that the expense attendant upon an annual repetition of such a demonstration as has been witnessed in New York during the year past, is a greater strain on a company than is a good sized "graft;" while the annual throwing of mud and the staining of a company's reputation, with the consequent loss of policy-holders and trouble in getting new members, entail far greater expense and loss than any sort of extravagance. On these grounds, the present officers oppose the changes in insurance laws revising methods of electing trustees.

If such conditions as indicated would result from any method enabling policy-holders easily to express their desires, then we should unite with the companies in opposing the new laws. However, it

[14] *Wisconsin Life Insurance Report,* 1903, Preface.

seems that the officials of the various mutual companies have become unduly alarmed. With complete power in the hands of the policy-holders and an easy method of voting devised, it is not at all probable that there would be an annual contest for control. A management which is capable and conscientious may be sure that policy-holders will have sense enough to keep it in power. Crafty financiers may seek to get a board of trustees elected of their liking, but they will soon learn the folly of going to the heavy expense of a campaign to oust an efficient management. It is almost safe to say that it will be many years before we shall witness another campaign like that carried on during the past year for control of the two large New York companies.

Some of the officials have expressed the fear that in a campaign for control of a mutual company, policy-holders will not know what is to their advantage. They, therefore, are afraid to trust the issues to them. Such statements remind one of the arguments in favor of an autocratic form of government. An autocratic form of government is good if the autocrat is wise and beneficent. But since the autocrats in the past have not always been wise and beneficent, a government responsible to the people has worked better. So it will be in life insurance corporations. Policy-holders are the company, its gain is their gain, its injury is their injury, and they will soon, if not immediately, begin to examine closely the men who are seeking their votes to oust an existing management.

Besides the natural conservatism of investors which will work in favor of the management in power, there is still another advantage which the officials possess. It will practically always happen that the agency force will work in favor of the administration party, and with the agency force so disposed, the men in power will have such an advantage in a campaign that even better men will have a hard task in defeating an adminstration ticket. This is as it should be. The end that is desired by those who see the evil of the old system is not an annual scramble for control of the companies, but such an easy method of removal that the officers will at all times be forced to keep in mind their responsibility to policy-holders.

A more fruitful question for discussion to the man who desires a change from the old system, is whether an easy and effective method of voting in mutual companies can be devised. New York

has made a serious attempt to put the policy-holders in control. In the revision of the insurance laws of the state, in 1906, it was provided that two lists of policy-holders' names and addresses should be filed with the Superintendent of Insurance at Albany, and two similar lists with the general agents in each state and foreign country; that the tickets be nominated by the administration five months prior to the election, and by an opposition party at least three months before the election; and that policy-holders should be allowed to vote in person, by mail, or by proxy.

One election has already taken place under the New York law. Some criticism may be offered of the method adopted. In the first place, the companies are bitterly opposed to that section of the law which provides for public listing of the names and addresses of policy-holders. The New York companies would rather have this provision repealed than any other of the so-called Armstrong laws. Officers of mutual companies in other states will make no compromise on this subject. The contention of the companies in this respect is well grounded. Such a public posting of names does a serious amount of damage to the companies compelled to obey the law. Agents of rival companies prize a list of policy-holders in another company very highly, not only for the purpose of twisting the policy-holders into their own companies, but also because the best purchasers of insurance are those who already have policies. For this reason, the companies regard this provision of the law as a violation of their rights not to be condoned.

Yet such a measure or some substitute for the measure, is absolutely necessary if there is to be any appreciable opposition to the administration party. In the past when there has been among policy-holders wide-spread dissatisfaction with a management, opposition has been ineffectual because it never could be united. If such opposition is ever to accomplish its ends, it must be concentrated, and no sort of co-operation is possible unless the policy-holders have some means of communicating with each other. So long as the administration alone possesses a list of the voters with their addresses, it has an advantage which a scattered opposition cannot overcome. All that is left to the opposition under these circumstances is communication by means of advertisements in the papers, an expensive method, as well as one of doubtful utility. Therefore, unless some method is devised of allowing the opposition to communicate freely with voters, the system of control by

policy-holders fails. However, it is not necessary that the list of names should be open to public inspection. It might be practicable to have all the literature which any opposition ticket may wish to send out addressed by the state at the expense of the opposition or even by the administration under the supervision of the state, but still at the expense of the opposition. Company officials do not take kindly to either suggestion, holding that the opposition has no right to this advantage of intercommunication. In doing so, they are carrying their opposition too far. The officials have no inherent right to hold their positions irrespective of the wishes of the policy-holder, and the latter rightly insist upon some means of close co-operation.

Insurance men are further opposed to the enactment of laws similar to those of New York, on the ground that the carrying-out of such a system of voting entails a very heavy direct expense. They point to the situation in New York where the cost of counting the ballots alone reached fifty thousand dollars for each one of the large companies. They assert that such an annual expense is a heavy burden to place upon the policy-holders, when, in most cases, it is not necessary. Without desiring to criticize too strongly the men who were in charge of the counting of the ballots in New York, it seems that the work was unnecessarily drawn out. As a matter of fact, if the inspectors of election appointed by the officials of the two large companies and paid by the companies twenty-five dollars per day for their services, had counted ballots as rapidly as do the judges of elections in our political contests, the votes would have been counted in perhaps a third of the time it did take to count them. As the ballots in the insurance election were the simplest possible to count—there being no spilt ballots and practically only one office for which to count, and in one case only two tickets, and in the other three, in the field—it does seem that the suspicion raised in some quarters that the contest was drawn out for political effect is well grounded.

If this is true, the heavy expenses of the present election cannot be used as an argument against the proposed changes. If the suspicion is without truth, and the elections are really expensive, it has been already pointed out that few elections will be carried out on the scale that the present contest has been waged. Admitting, however, that annual elections will cost from thirty thousand to fifty thousand dollars for each company, it is no conclusive argu-

ment against the reform measures. The states might well relieve the companies of taxation, and make them have annual elections for the sake of securing the gain that will accrue from such a change.

It should be noted that the reformers, as well as insurance officials, criticize the New York law. The Armstrong law still allows proxy voting. The application of proxy voting in mutual life companies is a misapplication of a system working fairly well in joint stock concerns. Under the old system of electing trustees, it was necessary to allow the officers to collect proxies, but when policy-holders are allowed to vote by mail, the system cannot be justified. The man, who under the reformed conditions gives his proxy, is the man who is not interested enough to care what the outcome is, and gives his proxy as a personal favor to the first one who solicits it. The administration is the only party which has the machinery necessary to solicit these proxies, therefore the disinterested or indifferent policy-holders control the outcome of the election rather than the men who are interested and have informed themselves. That administration tickets won it was largely due to the work of agents in soliciting proxy votes. While not desiring to express any opinion upon the outcome of the New York elections, as a general principle it is wrong that the careless and indifferent policy-holders should dominate the situation. Therefore, the right of proxy voting should be abolished.

Company officials need not be alarmed if such a system of voting as is here advocated be carried out. It will not mean frequent changes in management because such changes will be unnecessary. The system has been tried for many years in the largest company in the British Empire, the Australian Mutual Provident Society. No serious difficulties have arisen in connection with the operation of the system. There has been but one revolution in the company, and this one demonstrated the merits of the plan. Incidentally it is worth noting that this company has been one of the best managed in the world. Mr. Dawson says that in nearly all respects, dividends, economy of management, small ratio of lapses, growth and favorable mortality experience, its career is unprecedented.[15]

Some have said that these large companies cannot be run on the basis of control by policy-holders because the party system cannot

[15] *The Business of Life Insurance*, p. 128.

be adopted. It is hoped that the last part of this statement is true. The control of these business corporations should be free from politics. It would be suicidal to subject them to a change in management each year. This, as has been pointed out, is not contemplated in the proposed changes. Under the plan which is submitted, it is believed that managements will be just as stable as they have been in the past, indeed more so. At every election, it will be the administration against the field, and if the record of the men in power has been satisfactory, it will commend the administration ticket to the policy-holders. The desire to let well enough alone will be sufficiently strong to resist a change, and because there exists an easy method of turning out corrupt managements, these managements will try not to become corrupt. The officers will still have a chance to stay in the business for life, developing a great company, not because they control twenty or thirty thousand proxy votes, but because they are efficient.

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